

Message Text

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ACTION EB-07

INFO OCT-01 ISO-00 AF-08 ARA-06 EA-07 EUR-12 NEA-10 IO-13

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INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02 OPIC-03 SP-02

CIEP-01 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-04

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FM AMEMBASSY KUALA LUMPUR

TO SECSTATE WASHDC 5341

INFO AMEMBASSY BANGKOK

AMEMBASSY CANBERRA

AMEMBASSY JAKARTA

AMEMBASSY KINSHASA

AMEMBASSY LAGOS

AMEMBASSY LA PAZ

AMEMBASSY LONDON

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E.O. 11652: N/A

TAGS: EMIN, ITC

SUBJECT: DECEMBER MEETING OF INTERNATIONAL TIN COUNCIL

REF: STATE 276933

1. SUMMARY: FOLLOWING REPORT ANALYZES INCREASES
IN PRODUCTION COSTS IN MALAYSIAN TIN INDUSTRY. AS EXPECTED, COSTS
OF CAPITAL GOODS, POWER, TAXATION AND LABOR HAVE INDEED RISEN
OVER LAST THREE YEARS. IT IMPORTANT TO REALIZE HOWEVER
THAT MANY OF THESE INCREASES HAVE BEEN AS DIRECT RESULT OF
GOM ACTIONS AND CHANGING NATURE OF GRAVEL PUMP OPERATIONS.
EQUALLY IMPORTANT, COST OF TIN TO CONSUMERS, AS REFLECTED IN
AVERAGE, FLOOR AND CEILING PRICES HAVE ALSO RISEN SUBSTAN-
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TIALY. AS RESULT OF OUR ANALYSIS, IT DOES NOT APPEAR THAT

MALAYSIA CAN MAKE CREDITABLE CASE FOR INCREASE IN FLOOR AND CEILING PRICES BASED ON INCREASES IN COST OF IMPORTED CAPITAL GOODS. END SUMMARY.

2. EMBASSY UNABLE TO OBTAIN COST OF PRODUCTION DATA FROM GOM BUREAU OF MINES WHICH COLLECTED BI-ANNUALLY FROM SURVEY OF INDUSTRY AND IS CLOSELY HELD. THIS INFORMATION WILL UNDOUBTEDLY FORM PART OF GOM SUBMISSION AT FORTHCOMINT ITC MEETING.

3. BECAUSE LOCATION OF MALAYSIAN TIN RESERVES QUITE WELL-KNOWN, EXPLORATION DOES NOT REPRESENT IMPORTANT ELEMENT OF PRODUCTION COSTS AT THIS TIME.

4. CONSIDERATION OF COST OF CAPITAL EQUIPMENT AND PARTS MUST BE SPLIT INTO TWO AREAS: THOSE EFFECTING THE DREDGING OPERATIONS (WHICH ACCOUNTED FOR 31.6 PERCENT OF 1975 MALAYSIAN PRODUCTION OF TIN CONCENTRATES) AND GRAVEL PUMP OPERATIONS (54.7 PERCENT OF TIN PRODUCTION IN 1975). EMBASSY REVIEW OF 1975 ANNUAL REPORTS OF SEVERAL OF THE LARGEST DREDGING COMPANIES INDICATES THAT INCREASED COSTS OF CAPITAL EQUIPMENT WERE NOT A MAJOR PROBLEM HINDERING PROFITABILITY. FOR EXAMPLE, ANNUAL REPORT OF SOUTHERN KINTA CONSOLIDATED LIMITED (A LARGE LONDON-BASED COMPANY WITH OPERATIONS IN BOTH MALAYSIA AND THAILAND) CONTAINED THE FOLLOWING STATEMENT "DESPITE INFLATION OUR OPERATING COSTS AND OVERHEAD EXPENSES SHOW ONLY A MODEST INCREASE." SAME IS NOT ENTIRELY TRUE FOR GRAVEL PUMP OPERATIONS BUT CLEAR UNDERSTANDING OF THEIR CIRCUMSTANCES IS REQUIRED BEFORE DRAWING CONCLUSIONS RE FLOOR AND CEILING PRICES.

EMBASSY DISCUSSED PRICE OF DIESEL ENGINES AND PARTS WITH GENERAL MOTORS DISTRIBUTOR WHO CONTROLS A MAJORITY OF THE MARKET FOR DIESEL ENGINES IN THE TIN INDUSTRY. HE CONFIRMED THAT ONLY MAJOR PIECE OF CAPITAL EQUIPMENT OWNED BY A GRAVEL PUMP OPERATOR IS A DIESEL ENGINE. COST OF SUCH ENGINES HAS INDEED INCREASED SINCE 1973. AVERAGE INCREASES, EX-FACTORY, DURING THE PERIOD 1973 TO THE PRESENT HAS BEEN IN THE RANGE OF 30 TO 35 PERCENT. HE POINTED OUT, HOWEVER, TWO ADDITIONAL FACTORS WHICH HAVE INCREASED COST OF ENGINES FOR GRAVEL PUMP OPERATORS. THE FIRST IS GOM IMPORT DUTY LIMITED OFFICIAL USE

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OF 25 PERCENT ON DIESEL ENGINES, DESPITE THE FACT THAT THEY ARE NOT PRODUCED IN MALAYSIA. A SALES TAX OF AN ADDITIONAL 5 PERCENT AND A FURTHER 5 PERCENT SURTAX IS LEVIED ON TOP OF DUTY FOR AN EFFECTIVE DUTY RATE OF 37.5 PERCENT. SECOND REASON IS THAT MANY GRAVEL PUMP OPERATORS ARE HAVING TO INCREASE SUBSTANTIALLY SIZE OF ENGINES THEY REQUIRE BECAUSE THEY ARE GOING DEEPER AND NEED MORE POWER. IN 1973, AVERAGE OPERATION USED A DIESEL ENGINE IN THE 300-400 HP

RANGE. NOW THE SEME OPERATION IS MORE LIKELY TO BE IN THE 450-600 HP RANGE. EX-FACTORY PRICE OF GM'S 360 HP DIESEL IS U.S.\$15,000 WHILE A 600 HP ENGINE COSTS U.S. \$28,000, AN INCREASE OF ALMOST 87 PERCENT. THUS, MANY GRAVEL PUMP COSTS HAVE SIGNIFICANTLY INCREASED NOT ONLY BECAUSE OF INFLATION BUT ALSO DUE TO HIGH GOM TARIFFS AND THE NEED FOR MORE POWERFUL AND COSTLY EQUIPMENT.

5. IN MID-1975, GOM NATIONAL ELECTRICITY BOARD (NEB) LEVIED 60 PERCENT SURCHARGE ON INDUSTRIAL USERS OF ELECTRICITY. SURCHARGE MADE RETROACTIVE TO MARCH 1975. DESPITE APPEALS BY TIN INDUSTRY ASSOCIATIONS, SURCHARGE IS STILL IN EFFECT. TIN INSUDTRY SOURCES ESTIMATE THAT ELECTRIC POWER ACCOUNTS FOR ROUGHLY ONE-THIRD OF TOTAL OPERATING COSTS FOR A TIN MINE. AS PLANNED POWER STATIONS COME INTO OPERATION, THIS SURCHARGE MAY WELL BE LIFTED. IT HAS, HOWEVER, HAD AN ADVERSE IMPACT ON PROFITABILITY OF TIN INSUDTRY DURING LAST EIGHTEEN MONTHS.

6. SPECIAL CONCERN IS VOICED BY THE INDUSTRY OVER THE RISE IN THE PRICE OF DIESEL FUEL AND THE FACT THAT INDUSTRIAL USERS ARE CHARGED A HIGHER PRICE THAN ARE CONSUMERS. SINCE DECEMBER 1973, DIESEL PRICES HAVE INCREASED 28 PERCENT. INDUSTRY COMPLAINTS ABOUT TWO-TIER PRICING SYSTEM HAVE LESS VALIDITY. OIL INDUSTRY SOURCES STATE THAT PRESENT PRICE PAID BY INDUSTRIAL USERS REFLECTS TRUE ECONOMIC COST.

7. MOST WAGE INCREASES HAVE BEEN CONFINED TO DREDGING OPERATORS AND DO NOT APPEAR TO HAVE ADVERSELY EFFECTED THEM. IN CASE OF GRAVEL PUMP OPERATIONS, WAGES HAVE NOT GONE UP SUBSTANTIALLY AND THOSE OPERATIONS ARE NOT, IN ANY CASE, PARTICULARLY LABOR INTENSIVE.

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8. TAXATION RATES ARE PROBABLY THE MAJOR CONCERN OF THE TIN INDUSTRY. OF PARTICULAR NOTE IS THE EXPORT SURCHARGE IMPOSED IN APRIL 1974. THIS MEASURE (WHICH INCLUDES SLIDING SCALE AS TIN PRICES RISE) WAS IMPOSED AS AN ANTI-INFLATIONARY STEP AND WAS ORIGINALLY IMPOSED WHEN THE PRICE OF TIN EXCEEDED M\$700 PER PICUL. RECENTLY GOM RAISED THIS LIMIT TO M\$850 PER PICUL. WITH THE AVERAGE PRICE OF TIN NOW AT M\$1,120, INDUSTRY SOURCES INDUCATE THAT SURCHARGE TAKES AN EVEN HEAVIER BITE OUT OF PROFUTS. INDUSTRY SOURCES ALSO INDICATE THAT GOM TAXES AND THE SURCHARGE TOGETHER TAKE IN EXCESS OF 70 PERCENT OF THE TOTAL PROFITS OF MANY COMPANIES. THIS IS ILLUSTRATED IN THE ANNUAL REPORT OF AUSTRAL AMALGAMATED WHICH HAD A BEFORE TAX AND EXPORT SURCHARGE PROFIT OF M\$11.2 MILLION.

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THE SAME FIGURE AFTER TAXES WAS M\$3.2 MILLION, A TAX BITE OF 72 PERCENT.

9. 1975 PROFUT AND LOSS DATA WAS OBTAINED ON SIX DREDGING COMPANIES FROM THEIR ANNUAL REPORTS. EMBASSY BELIEVES THEY REFLTECT INDUSTRY EXPERIENCE DURING LAST YEAR. ALL DATA IS IN MILLIONS OF M\$.

COMPANY	BEFORE TAX	AFTER TAX	CHANGE FROM 1974
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	PROFIT	PROFIT	
AUSTRAL AMALGAMATED	M\$11.2		M\$ 3.2 PLUS M\$2.5
BERJUNTI TIN	M\$31.3	10.0	MINUS M\$4.5
KAMPONG LANJUT	M\$ 1.0	.6	MINUS M\$1.4
KRAMAT TIN	M\$1.5	M\$.2	MINUS M\$.4
KUALA KANGSAR	M\$2.5	M\$.6	MINUS M\$1.2
LOWER PERAK TIN	M\$1.4	M\$.2	MINUS M\$.6

10. BECSUE OF GOMPOLICIES DESIGNED TO INCREASE THE NUMBER OF MALAYS IN TIN INDUSTRY (WHICH IS PRESENTLY DOMINATED BY MALAYSIAN CHINESE AND FOREIGNERS), LITTLE NEW INVESTMENT IS EXPECTED IN THE SHORT TERM. OVER THE LONGER TERM, AS THE GOM TAKES A LARGER SHARE IN THE INDUSTRY, INVESTMENT IN OPEN CAST AND OFF-SHORE DREDGING OPERATIONS SHOULD INCREASE SUBSTANTIALLY. AT PRESENT, HOWEVER, NEW INVVESTMENT IS NOT ADDING TO COSTS.

11. AS OF JANUARY 1976 (MOST RECENT DATA AVAILABLE), STOCKS ON HAND OF TIN-IN-CONCENTRATE AMOUNTED TO 6,204 TONS. TIN METUL STOCKS AS OF THE SAME DATE WERE 8,723 TONS.

12. THROUGH FIRST NINE MONTHS OF 1976, MALAYSIAN PRODUCTION OF TIN-IN-CONCENTRATES AMOUNTED TO 47,752 TONS. SIMPLE PROJECTION WOULD YIELD ANNUAL RATE OF 63,669 TONS FOR 1976.

13. WHILE NOT SPECIFICALLY MENTIOED IN REFTEL, EMBASSY BELIEVES THAT THIS ANALYSIS WOULD BE INCOMPLETE WITHOUT LOOKING AT THE INCREASE SINCE 1973 OF THE AVERAGE, FLOOR ANC CEILING PRICES OF TIN. IN 1973, AVERAGE PRICE PER PICUL OF TIN WAS M\$685.51, FLOOR PRICE WAS M\$635 AND LIMITED OFFICIAL USE

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CEILING PRICE WAS M\$760. AT PRESENT, AVERAGE PRICE IS M\$1,120.77, FLOOR IS M\$1,000 AND CEILING IS M\$1,200. THESE REPRESENT PRICE INCREASES OF 63.5 PERCENT FOR AVERAGE PRICE, 57.5 PERCENT FOR FLOOR AND 57.9 PERCENT FOR CEILING. IF PRODUCER RECOMMENDATION THAT FLOOR BE RAISED TO M\$1,150 AND CEILING TO M\$1,430 IS ACCEPTED, INCREASES SINCE 1973 IN THESE CATEGORIES WILL BE 81.1 PERCENT AND 88.2 PERCENT RESPECTIVELY.

14. COMMENT: BASED ON ABOVE ANALYSIS, IT DOES NOT APPEAR THAT MALAYSIA HAS A CREDITABLE CASE FOR AN INCREASE IN FLOOR AND CEILING PRICES, ESPECIALLY IF ARGUMENT BASED ON INCREASED COST OF IMPORTED CAPITAL GOODS. IT SHOULD BE REMEMBERED THAT WHILE THESE GOODS HAVE INCREASED SINCE 1973 IN THE RANGE OF 30-35 PERCENT, AVERAGE TIN PRICES HAVE GONE UP 63.5 PERCENT DURING SAME PERIOD. INDEED, ANY

DISTRESS MALAYSIAN TIN INDUSTRY MIGHT FEEL IN TERMS OF PROFITABILITY IS MUCH MORE READITLY EXPLAINED BY GOM POLICIES THAN BY INCREASES IN COST OF CAPITAL GOODS. POLICIES INCLUDE HIGH TAXES, HIGH TARIFF RATES FOR REVENUE PURPOSES AND SURCHARGES ON ELECTRICITY, ALSO BEYOND REALM OF CAPITAL GOODS PRICE INCREASES IS FACT THAT GRAVEL PUMP OPERATORS NOW PURCHASING LARGER AND MORE COSTLY EQUIPMENT. IF GOM DELEGATES AT FORTHCOMING ITC COMMITTEE MEETING TAKE STRONG STAND IN SUPPORT OF BOLIVIAN DESIRE TO RAISE FLOOR AND CEILING PRICES, QUESTION OF GOM BITE COULD BE USEFULLY RAISED.

15. EMBASSY HAS CONCLUDED THAT GOM RAISING SUBSTANTIAL REVENUES BASED ON GAP BETWEEN BOLIVIAN AND MALAYSIAN MINING COSTS. THESE INCLUDE CUSTOMS AND TAXATION REVENUES AND GOM TAKE COULD APPROXIMATE DIFFERENCE BETWEEN PRODUCTION COSTS IN TWO COUNTRIES. RAISING FLOOR PRESUMABLY REQUIRED FOR LEAST EFFICIENT PRODUCER TO MAINTAIN MAXIMUM PRODUCTION. THIS APPEARS TO PLACE ENTIRE BURDEN OF THESE INEFFICIENT OPERATIONS ON SHOULDERS OF CONSUMERS AND ALSO RESULTS IN GREATER WINDFALL PROFITS FOR MORE EFFICIENT PRODUCERS LIKE MALAYSIA.
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